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SUBJECT: CEPA'S SERVICE SECTOR LIBERALIZATION MEASURES
LARGELY FALL FLAT

REF: HONG KONG 1847

¶1. (SBU) Summary: EconOffs from Consulates General Guangzhou and Hong Kong jointly met on September 28 with service sector leaders in Hong Kong to discuss their investment plans in China's Guangdong Province, especially as they relate to the Closer Economic Partnership Arrangement (CEPA) between the PRC and the Hong Kong government (HKG). The latest annual supplemental agreements to CEPA aimed to ease the cross-border licensing and movement of firms and professionals engaged in the service sector, but leading lawyers, doctors and accountants in Hong Kong say CEPA has thus far had little impact on them. They say lower prevailing rates of hourly billing in China limit the attractiveness of that market, while professional exam requirements in both Hong Kong and China continue to impede licensing of service sector professionals. CEPA-related service sector effects have been most noticeable in the banking industry, where international and Hong Kong-based banks use CEPA to significantly expand their retail branch networks in China's Guangdong Province. Government officials in Hong Kong and Guangdong are expected to complete by year-end a joint framework for cross-boundary cooperation. It will reportedly contain specific additional measures to boost service sector integration. End summary.

¶2. (SBU) Comment: CEPA has expanded trade opportunities in material goods. But with the exception of banking, CEPA-related efforts to improve cross-border service sector opportunities have thus far largely fallen flat. Doctors, lawyers and accountants have mostly not crossed the border in either direction. Service sector protectionism in Hong Kong and China masquerades under the guise of licensing requirements, while language differences, distrust and divergent billing rates contribute to the service sector integration challenge. Service sector integration can only be achieved when significant numbers of firms and professionals can become licensed to operate profitably on both sides of the border. Additional efforts by the HKG, PRC and Guangdong provincial governments will be required to design, implement and enforce the measures necessary to fulfill this CEPA service sector vision. End comment.

HK Law Professionals Barred from Local Practice in PRC

¶3. (SBU) Law Society President Huen Wong said CEPA will continue to have little near-term impact on Hong Kong-based law firms and lawyers, as they remain barred from establishing wholly-owned law offices and practicing PRC law in the Mainland. Hong Kong's law firms and lawyers are classified as foreign under PRC law and, like other foreign entities, they may only establish "associations" in the Mainland with a PRC firm. Only six Hong Kong-registered law

firms have established such associations with PRC firms in the Mainland (two in Shanghai, one in Beijing, one in Tianjin, and two in Guangzhou). Wong said, "None of the associations are extensive." Law Society Vice President Junius Ho said his law firm received approval in February 2009 to establish an association with a Mainland firm in Guangzhou, largely to source business from Mainland firms needing advice about Hong Kong law.

14. (SBU) PRC law firms, on the other hand, may establish wholly-owned subsidiaries in Hong Kong that are authorized to practice Hong Kong law after three years of continuous operations here. In July 2009, China's largest law firm (King and Wood) became the first PRC law firm to become fully qualified to practice local law in Hong Kong. The company will retain its status as long as Hong Kong-registered lawyers account for at least half of the local subsidiary's total staff of lawyers. According to Ho, a second PRC law firm (Jun He) will become certified to practice Hong Kong law here by March 2010.

CEPA's Small Impact on Hong Kong Accountants

15. (SBU) Institute of Certified Public Accountants (ICPA) President Philip Tsai said CEPA has had "little impact" on the small and medium-sized practices (SMPs) that comprise the bulk of ICPA's membership. The "Big Four" global accounting firms have longstanding joint ventures with PRC accounting firms that handle the international auditing and tax consulting work required by large PRC firms. The less lucrative profit potential offered by the PRC's smaller firms

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has not yet attracted many Hong Kong-based accounting SMPs to the Mainland, according to Tsai. He said, "The local market in Guangdong must have sufficient demand for Hong Kong-style services, before our members will set up shop there."

16. (SBU) Tsai said other factors have dissuaded Hong Kong's CPAs from expanding into the Mainland. Local accounting SMPs remain barred from owning equity stakes in PRC accounting firms, and the Chinese Institute of Certified Public Accountants (CICPA) exam requires further "modernization" to better assess examinees' accounting skills. In addition, the CICPA exam was offered only in Mandarin prior to 2009. This acted as a "major impediment" to Hong Kong's CPAs, according to Tsai, as "most speak English better than Mandarin."

Hong Kong Doctors Slowly Test Guangzhou Waters

17. (SBU) Using CEPA-related liberalization procedures, Hong Kong medical doctor Henry Leung and five local partners submitted an application to Guangzhou municipal authorities in March 2009 to establish the first-ever outpatient clinic in Guangdong to be wholly-owned by Hong Kong investors. The 300 square meter medical and dental clinic is to be staffed "mostly by local Guangzhou doctors," according to Leung. If the operation attains sufficient profitability, the investor group plans to open a chain of similar clinics in Guangdong and eventually complete an initial public offering of shares. The application for the first clinic has not yet been approved. Leung said, "I've been in touch regularly with the Hong Kong government's Trade and Investment Department, and they've been talking with the Guangzhou authorities about our pending application. We're not sure what has caused the delay, but we hope to be approved soon."

18. (SBU) While CEPA has enabled Hong Kong-certified doctors to practice in Guangdong, Hong Kong Doctors Union President Henry Yeung said few Hong Kong doctors have crossed the border. "There's less money to be made there," he said. Movement of medical doctors in the other direction - from the PRC to Hong Kong - remains severely limited. While many PRC doctors are enticed by the potential for higher earnings in

Hong Kong, the local medical licensing exam is conducted in English. Yeung said this poses a significant barrier to PRC doctors, as "only one or two percent of them have the necessary English skills to pass Hong Kong's exam." Yeung noted that Hong Kong has a "surplus" of doctors and implied that competition from PRC doctors would not be warmly welcomed here.

Further Implementation Measures Under Design

¶9. (SBU) Polytechnic University Research Fellow and Bauhinia Foundation Research Centre Advisor Zhu Wenhui referenced Leung's situation in a recent PRD integration analysis he and his Bauhinia colleagues will soon provide to the HKG and Guangdong provincial governments. According to Zhu, the two governments will complete by year-end a "framework for economic integration and cross-boundary cooperation," in support of China's 12th five year plan. He said the framework will "include mechanisms that assign CEPA-related responsibilities to local officials, including the establishment of reasonable decision-making timeframes and other specific guidelines." Zhu said Bauhinia will also suggest that PRC, HKG and Guangdong officials establish a permanent secretariat to work full-time on economic integration issues. The entity would act as a focal point for policy-making, as well as address specific integration-related challenges and complaints. Zhu's comments echoed those of Bauhinia Chairman Anthony Wu to Hong Kong Econoff on September 9, with regard to the need for enhanced CEPA-related cooperation by municipal officials in Guangdong (reftel).

¶10. (U) Consulate General Guangzhou has cleared this joint reporting cable.
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